

**INITIAL STATEMENT OF REASONS
FOR AMENDMENTS TO CALIFORNIA CODE OF REGULATIONS,
TITLE 18, REGULATION SECTIONS 23701(i) and 23772(d)**

**PUBLIC PROBLEM, ADMINISTRATIVE REQUIREMENT, OR OTHER CONDITION OR
CIRCUMSTANCE THAT THE REGULATION IS INTENDED TO ADDRESS**

The proposed amendments to the existing regulation are intended to conform to recent changes in the statutory language of Revenue and Taxation Code section 23701d.

SPECIFIC PURPOSE FOR AMENDMENTS TO THE REGULATIONS

AB 897, Stats. 2007, ch. 238, amended section 23701d of the Revenue and Taxation Code to change the rules for California income and franchise tax purposes for organizations that are exempt under Internal Revenue Code section 501(c)(3). As the legislative purpose of AB 897 is to allow federal law under Internal Revenue Code section 501(c)(3) to control, to the extent that existing California regulations conflict with federal law under Internal Revenue Code section 501(c)(3), consideration of any conflict in existing regulations is required to effectuate the Legislature's intent in AB 897. Therefore, to effectuate the legislative purpose of AB 897, the proposed amendments to the existing regulations will allow incorporated subordinates to be able to obtain tax exemption by virtue of being part of a group.

NECESSITY

As previously noted, the legislative purpose of AB 897 is to allow federal law under Internal Revenue Code section 501(c)(3) to control, and, to the extent that existing California regulations conflict with federal law under Internal Revenue Code section 501(c)(3), consideration of any conflict in existing regulations is required to effectuate the Legislature's intent in AB 897. As described more fully below, the existing regulations are in conflict with relevant federal law.

Specifically, both California and federal law recognize a group of organizations as tax-exempt if they are affiliated with a central organization (one which has one or more subordinates under its general supervision or control). The concept of a central organization applying for tax exemption for itself and its subordinates (i.e., chapter, local, post, or unit) is known as a "group exemption."

However, there is a distinction between federal and California law regarding "group exemption." This occurs because under federal law, both incorporated and unincorporated subordinates are eligible for a group exemption. Conversely, under existing California regulations, only unincorporated subordinates are allowed to obtain their tax exemption by virtue of being part of a group. (See Regulation sections 23701(i) and 23772(d).) In California, incorporated subordinates must submit an individual application with fee to establish exempt status. (See Regulation sections 23701(i) and 23772(d).) Therefore, to effectuate the legislative purpose of AB 897, the proposed amendments to the regulations will allow incorporated subordinates to be able to obtain tax exemption by virtue of being part of a group.

TECHNICAL, THEORETICAL, AND/OR EMPIRICAL STUDY, REPORTS, OR DOCUMENTS RELIED UPON

The Franchise Tax Board relied upon the following provisions: (1) Revenue and Taxation Code sections 23701d and 23772; (2) California Code of Regulations, Title 18, Regulation sections 23701(i) and 23772(d); and (3) Internal Revenue Code section 501(c)(3) and supporting Treasury Regulations. The Franchise Tax Board did not rely upon any other technical, theoretical, or empirical studies, reports or documents in proposing the amendments of these regulations.

REASONABLE ALTERNATIVES TO THE AMENDMENTS TO THE REGULATIONS AND THE AGENCY'S REASONS FOR REJECTING THOSE ALTERNATIVES

There were no other alternatives presented to or considered by the Franchise Tax Board which would be more effective in carrying out the legislative purpose of AB 897 or that would be as effective and less burdensome to affected individuals.

ALTERNATIVES TO THE PROPOSED REGULATORY ACTION THAT WOULD LESSEN ANY ADVERSE IMPACT ON AFFECTED PRIVATE PERSONS OR SMALL BUSINESS

The proposed amendments to the regulations do not create any adverse impact on the affected individuals, and in fact they are "taxpayer friendly" in that they allow incorporated subordinates to be able to obtain tax exemption by virtue of being part of a group, as opposed to having to file for California tax exemption separately as under the existing regulations.

ADVERSE ECONOMIC IMPACT ON BUSINESS

The Franchise Tax Board has determined that proposed amendments to Regulation sections 23701(i) and 23772(d) of Title 18 of the California Code of Regulations will not have a significant overall adverse economic impact on business.